SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1945

No. 889

ESTATE OF R. A. SEWELL, JOSEPHINE M. SEWELL, EXECUTRIX,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

BRIEF IN SUPPORT OF PETITION

At regrettable though unavoidable length, but we trust without prolixity in view of the many conflicting decisions and important questions involved, we have endeavored to state such questions and reasons for granting the writ of certiorari with sufficient clarity and fullness to give this Court a clear picture of the situation, in respectfully appealing to its discretion for the grant of the writ.

Since it seems out of place to argue at this time the *merits* of the case, we now only state our insistence that the courts below erred in deciding each of the questions and matters stated adversely to your Petitioner; and that the Gifts and Partnership involved were each valid under the controlling Federal and State statutes and rules of

law; so that the refusal to allow a determination of the alleged income tax deficiencies in each of the tax years in question was error.

Only slight elaboration will here be added to the statement of "Questions" and "Reasons for Granting the Writ," as made in the Petiton, since we hope that these have been presented with sufficient clarity to avoid the necessity of burdening the Court with argument thereon.

This Brief, therefore, is devoted almost wholly to a summarized analysis of the *Opinions* below, in showing that the holdings on the *"Questions"* hereinbefore stated were controlled by erroneous rules of law, as indicated; and—*for reference* by this Court if desired—to a more detailed statement of the facts.

Jurisdiction

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (28 U. S. C. A., Sec. 347). The judgment of the Circuit Court of Appeals for the Fifth Circuit was entered on November 9, 1945 (R. 206-209). Petitioner filed her petition for rehearing on November 29, 1945 (R. 210); and the Circuit Court of Appeals entered its order and judgment denying such petition for rehearing on December 28, 1945 (R. 218).

Opinions of the Courts Below

Tax Court. The decision of the Tax Court and its Memorandum Findings of Fact and Opinion, pursuant to which the decision was entered, have not been reported; but the former appears in the Record at pages 84, 85, and the latter (relating to Petitioner) at pages 34-44, 46-52, 55-71, 76-78.

As to Gifts. The Tax Court in its opinion recognized that "a manual delivery of stock certificates is not always necessary to consummate a valid gift of the stock, and under certain circumstances transfer on the books of the corporation in itself has been regarded as a sufficient delivery." (Citing decisions to that effect.) But the Tax Court failed to apply those decisions, and held that it was not necessary to decide whether the "*manner of delivery*" was sufficient, because of its holding in the case that "the actions of the parties *subsequent* to the transfers (of stock) in question were such as to negative the existence of *donative intent* in each case" (All added emphasis in this Brief ours); that, to make a valid gift, there must be "the irrevocable transfer of the present legal title and of the dominion and control of the entire gift to the donee, so that the donor can exercise no further act of dominion or control over it; and a delivery by the donor to the donee of the subject of the gift or of the most effectual means of commanding the dominion of it" (Citing *Adolph Weil*, C. C. A. 5th Circuit, 82 F. 2d 561, 31 B. T. A. 899, 906); that "the subjective state of mind • • • must be found not only from their testimony of what they intended, but also from an examination of all the circumstances *surrounding* each transaction;" that "*surrounding* circumstances, including *subsequent acts* of the taxpayer, often establish intent more clearly than the words of the participants" (citing Tax Court decisions); and, as above stated, "we think the *actions* of the parties *subsequent* to the transfers in question were such as to negative the existence of *donative intent*" (Memo. Opin. 47, 48, 52). However, in dealing with the question of fraud penalties and tests therefor, the Court held: "In our opinion the evidence of fraud in the instant proceedings does not meet those tests. It is one thing to hold that the petitioners did not make *completed* gifts of the stock transferred to

their wives, but quite another to say that their failure to report the dividends thereon was motivated by fraud *and unlawful intent* (Citation). It is possible that they had the opinion that what they did was *legally sufficient* to relieve them of liability for tax. • • • We disagree with their contention that the transfers had that effect, but *cannot say that they were shams designed to evade tax*" (R. 77, 78).

Court of Appeals. As to *Gifts*—the Court of Appeals (151 F. 2d 806; Adv. Sheets; R. 206-209, 218), in affirming that decision, and in holding that "among the indispensable conditions of a valid gift is the intention (of the donor) to absolutely and irrevocably divest himself of title, dominion, and control of the subject of the gift," cited as the basis therefor decisions without pertinence to any questions relating to the alleged gifts except as to the *manner of delivery* necessary to make a valid gift of corporate stock; the decision cited thereon indicating, as the Tax Court also indicated by its language above quoted and citation of the *Weil* decision (82 F. 2d 561, 31 B. T. A. 899, 906), that a physical delivery of corporate stock certificates, besides a transfer on the books, was necessary. As to *Gifts*—the Appellate Court in its opinion made no express reference to the Federal income tax statutes, or special rules relating to their construction, or State rules, but ignored them, and treated the gift question, under general law, as one of gift or no gift depending "upon the *intent* of R. A. Sewell in making the gift," and held this "was a question of fact that the Tax Court has answered adversely to the contention of the Petitioner" (R. 208). The courts below dealt with the question of donative intent or dominion and control as one under general law, but failed to apply the correct rules of general law, or of local law, or of Federal law under the income tax statutes.

As to *Partnership* (in 1936 or 1937)—the *Tax Court* based its decision thereon primarily upon its preceding holding that the alleged stock *gifts* were invalid, and therefore the stock and its proceeds always belonged to R. A. Sewell, the husband; and Josephine M. Sewell, never having had anything to contribute, contributed nothing to the partnership capital, and never became a partner. The Tax Court noted, but failed to apply, the rule that "the fact that the capital contributions made by the wife or the children were acquired by *gift* from the husband or parent is not determinative against the existence of such a partnership"—since, as the Court held, "the Petitioner's position here * * * is not that the decedent made a *gift of a capital interest* in the hat business to his wife, but rather that she *purchased* such an interest with funds of her own. (Reference to this misconstruction of the Record as to her 'position' is made under 'Additional Facts' in this Brief and in the preceding petition.) That position we have already held untenable." The Tax Court further held that it need not consider "whether under different circumstances there would have been *gifts of a capital interest* to Mrs. Sewell, and by her in turn to the children." For the same reasons, it failed to consider what effect the written trust agreement between Mr. and Mrs. Sewell (even if not executed until the middle of 1937), and the limited partnership agreement between them individually and as trustees, both by undisputed evidence having been made by July 1, 1937, had upon the existence of a *limited* partnership (valid under Georgia law); and what effect the preceding oral agreement as to a *general* partnership and as to the trust interests given to their four minor children had upon such a partnership, in either 1936 or 1937. And the Court simply held that no sort of partnership ever existed; adverting to the fact that "the record does not indicate the extent to which Mrs. Sewell *participated in the*

management of the business," with a slight exception noted, and the fact that "she took no particular part in the *actual running of the business*" (R. 67-71).

The *Court of Appeals* (151 F. 2d 806, Adv. Sheets; R. 206, 209, 218) affirmed generally these holdings, ruling that the Tax Court's conclusion "on the invalidity of the family partnership is equally well founded *in law and fact. The funds that went into the establishment of the alleged partnership were the money and property of the husband,* under the decision of the Tax Court. All the evidence leads to the conclusion that (he) *was the sole owner* of the hat business during the tax years here under consideration * * * the decision of the Tax Court is supported by substantial evidence" (R. 208). The decision cited to support this holding (except the familiar ones laying down rules as to trusts, income or corpus questions in tax cases, in no wise pertinent to the instant questions) were partnership cases where the profits or earnings depended upon the *technical skill* or *personal services* of the husband in a business of such type, but not a mercantile or manufacturing business as in the present case. Both Courts failed to apply the local law of the State, recognizing the validity both of general and limited partnerships where the wife contributes only to capital, without actively participating in the management or control of the business.

Additional Facts

In the *Questions* stated in the preceding Petition, the uncontroverted facts required for each determination (as is necessary in nearly all questions of law) have been integrated as briefly as possible. But for *reference,* if a more detailed picture is desired as to any question, a summary is here added, with notations where the particular facts appear in the Record.

During the transactions involved, Sewell Manufacturing Company was a Georgia corporation, in which R. A. Sewell, his two brothers and others (including the secretary and treasurer) were stockholders; the former being chairman of its board of directors (R. 109, 133, 173, 185, 193, 194; Memo. Opin., R. 37). On January 2, 1934, R. A. Sewell, after having stated to his wife, Josephine M. Sewell, and to others, his intention to give her stock of the Company, "in order," as stated to one, "to provide for his wife and children," had stock certificates for 1,000 shares in the Company, standing in his name, marked "Canceled" and new certificates therefor issued in her name, sealed and signed by the Company's officers. These certificates were not physically delivered to her, but according to the practice of the Company and its stockholders (including holders outside of the Sewells), remained in the Company's stock certificate book, kept at all times in the vault at its offices, and there accessible to Josephine M. Sewell. On July 31, 1936, under similar facts, R. A. Sewell made to her a transfer of 300 additional shares. (R. 104, 105, 108, 109, 112, 113, 122, 123, 152, 175, 178, 186, 189, 195, 196; Documentary Evidence, W. P. Sewell case, Exhibits 1, 2—Certificates of Stock Nos. 8, 11-13, 38-41, 44, 45, 75; Doc. Ev. R. A. Sewell case, Exh. 13; Memo. Opin., R. 37, 38).

Josephine M. Sewell did not indorse any of the certificates at the time of their issuance to her, or earlier than in the following Fall or not until about the time of a first sale of stock by her on December 29, 1934; subsequent sales being made on June 1, September 21, and October 5, 1935; on October 31, 1936, and on October 31 and November 9, 1937 (R. 113, 117, 123, 155; Petrs. Doc. Ev., Exh. 13). On October 31 and December 18, 1936, she also executed written pledge contracts to secure loans to her, covering 317 of the shares that had been assigned to her in

the alleged gifts; these instruments (as to stock held in her name) being signed by Mrs. Sewell herself as pledgor and by the pledgees, and recorded in the public records; the validity of such instruments for their purported purpose not being questioned in this case, their reality being recognized by the Tax Court in its findings and opinion as to whether gains were taxable in 1936 or 1937 (R. 129-132; Memo. Opin. 57-62; Petrs. Doc. Ev., Exhs. 13, 22-26).

"In the handling of the financial affairs of (the) corporation" with its stockholders, its books were "practically made • • • a bank" by the president for their use; the Sewells and other stockholders having "a financial account on (its) books. The dividends were paid merely by crediting them on the books." Monies due to or by them were handled by debit and credit entries. Josephine M. Sewell and R. A. Sewell had such separate accounts. In 1934, dividends of $14,000 for that year on the stock in question were thus credited to her account. On December 29, 1934, proceeds from a sale of part of the stock involved were also thus credited to her account. Such 1934 monies remained to her credit (subject to her disposal as she desired, so far as shown by the Record), until a debit for payments of her income taxes in March 1935, and a transfer of the balance in her account to the account of R. A. Sewell on May 20, 1935. Later, other credits were entered in her account during June, September, and October 1935, and February, March, April, May, October, and December 1936; consisting partly of dividends on the stock involved, but mostly of proceeds from her sales and pledges of such stock (as above stated), and interest on the monies to her credit charged against the Company. These monies remained to her credit, not withdrawn by her, until their transfer to R. A. Sewell's account on October 21 and December 30, 1935, and October 31 and December 18, 1936. Other than by such transfers of proceeds from the

stock to his account on the Company's books, and his use of such funds in building and equipping a hat manufacturing business, known as Sewell Hat Manufacturing Company and Sewell Hats (involved in questions as to whether that business was a partnership)—there was nothing to indicate any retention or assertain by him of dominion or control over the alleged gifts of stock or its proceeds (R. 175, 117, 121, 122; Petrs. Doc. Ev., Exhs. 20, 21, 13, 18, 19; W. P. Sewell case, Exhs. 1, 2).

Early in 1935, R. A. Sewell made to the Government income tax authorities a sworn Gift Tax Return, reporting the 1,000-shares alleged gift (made on January 2, 1934), and in 1937 the 1936 alleged gift of 300 shares, and paid the Gift Taxes on both transactions. Josephine M. Sewell attached to each of those Returns her signed acknowledgment of the gift, certifying to the Government that "all the information given herein is correct" (Petrs. Doc. Ev., Exhs. 1, 3; Memo. Opin., R. 38, 39). She also made Individual Income Tax Returns to the Government, returning as her income the dividends and profits from sales and pledges of the stock in question during those tax years, and paid the taxes thereon. R. A. Sewell in his Individual Returns for those years made no such inclusion (Petrs. Doc. Ev., Exhs. 7-10).

As to *Partnership* of Sewell Hat Manufacturing Company or Sewell Hats—Mrs. Sewell's testimony was that she had "loaned" to her husband the monies transferred to his account on the corporate books of Sewell Manufacturing Company, to be used in the building and equipment of the plant (under the former trade name). The testimony of the Government's revenue agent was that, although she denied to him having made any "loan" to her husband, she informed this agent as to the alleged gifts and the dividends, and stated to him that "she knew every time a dividend was credited to her account her in-

terest in the business was increasing, and that she left them in the business so that the Company could avoid making bank loans," and that her husband "had her permission in his capacity as directing head of the Company (chairman of its directors) to use them for the Company's benefit" (R. 152, 153, 155, 156, 160). The funds from the wife's account thus used in the creation or operation of the hat business amounted to a total of $222,255.54, while Sewell's contribution to the capital from other funds amounted to $138,945.07. The Tax Court found similar proportionate investments (Memo. Opin. 62; Petrs. Doc. Ev., Exhs. 18, 19; R. 121, 122).

Mr. and Mrs. Sewell orally agreed that, by reason of her contribution of monies used by him in building and equipping the hat plant, a partnership would exist between them, from the beginning of the 1936 business, which started on February 27, 1936; after a 1935 sole proprietorship by Sewell, the taking over and operation of the business by W. P. Sewell in the latter part of that year, as "a brotherly act", during an illness of R. A. Sewell, and the deed of the properties back to the latter after his recovery. Although there were no entries on the books of Sewell Hat Manufacturing Company until the close of business, December 31, 1936, when the wife's alleged interest was entered, R. A. Sewell during 1936 informed several persons as to the existence of a partnership between him and his wife. A witness for the Government, familiar with the financial transactions of the parties, testified that it was his "understanding there was a verbal partnership" between husband and wife, which was carried forward later into a limited partnership. This was under a written trust agreement and a limited partnership agreement, the former executed as a formal instrument about the middle of 1937 (although it bore date of June 1, 1936), and the latter on July 1, 1937. Under those instruments, it

was agreed that the husband and wife had equal interests; and their four minor children (at first having a 20 percent interest) a 33⅓ percent interest; the husband and wife being made trustees as to such interests; and the evidence being that the husband and wife had previously orally agreed as to those interests. Under the limited partnership instrument, Sewell was the general partner, and the wife and children limited partners; the formalities of the Georgia statutes as to such partnerships being complied with.

The written trust agreement recited that Mrs. Sewell had "*purchased* and paid for" her undivided interest in the hat manufacturing business; to which reference was made by the Tax Court in its Findings and Opinion (as heretofore stated). The Record nowhere indicates that she as Petitioner (executrix of the decedent), in her contentions as to a partnership in both 1936 and 1937, has based her position upon a "purchase" of an interest, any more than upon a gift, or upon an implied trust (created by Georgia law in favor of a wife whose husband uses her monies either "with or without the wife's consent"), or upon any particular theory other than her contribution to the capital, the husband's use of her monies, the oral and written agreement as to a partnership, and the operation of the business as such.

In financial statements to obtain credit filed by Sewell with two banks as of May 31, 1936, he stated that he was the owner of the business. There was nothing else to indicate his proprietorship during 1936 or 1937 except his management of the business without the active participation of the wife. In March, 1937, he filed with the Government tax authorities a Partnership Return as to Sewell Hat Manufacturing Company for 1936, showing that it was a partnership composed of Mrs. Sewell and himself, owning a 40 percent interest each, and their four chil-

dren owning 5 percent each, with the profits of the business divided accordingly. He filed in February 1938 a like return for 1937, showing (according to the trust and limited partnership agreements) a limited partnership composed as stated, with a 33⅓ percent interest in each parent, and 8⅓ percent in each child. Gift tax returns as to the parents' gifts to the children of their interests were also filed with the Government. In their separate Individual Income Tax Returns, Mr. and Mrs. Sewell showed profits accruing to them from the business as a partnership, and not as a sole proprietorship owned and operated by him. In 1938, Reconstruction Finance Company lent $75,000 to the business as a partnership, and Mr. and Mrs. Sewell, signing individually and as trustees, executed the security deed as a partnership (R. 151-154, 135-137, 140, 128, 124, 125, 141, 143, 165, 167, 145-147, 148, 149, 120, 122; Petrs. Doc. Ev., Exhs. 5, 10-12, 14-19, 31, 32; Respondent's Exhs. A, B; Memo. Opin. 63-71).

Assignments of Error

Under Rule 38 (par. 2) of this Court, we have embodied with the "Questions Presented" in the Petition the errors especially to be considered, to which we respectfully refer, without repetition, as part of this Brief. We respectfully insist that the Court of Appeals and the Tax Court erred in decided adversely to Petitioner on each of the grounds set forth in her Petition for Review (R. 88-100).

Argument

1. The decisions of the courts below were manifestly based, as to both Gifts and Partnership, on clear-cut errors of law, in applying to uncontroverted facts erroneous legal standards, criteria, and rules, and in failing to apply the true and correct legal principles.

2. The decision, as to donative intent in gifts and their nullification, long after completion, by the donee's mere use of proceeds from the gifts, and the decision that the transfers of stock on the corporate books did not complete the gifts (taken with the uncontroverted acts of the parties), and in failing to apply to the gifts in question the rules of local law making such a constructive or symbolic delivery sufficient, were each in conflict with the decisions of the Circuit Courts of Appeal and of the State of the transactions, as stated in the Petition, as well as contrary to previous decisions of the courts below themselves, and contrary to general law.

3. The decision, as to partnership, that there had been no valid gifts by husband to wife, that she had "purchased" no interest in such business and contributed nothing to the capital (erroneous as a matter of law for the reasons heretofore stated), and the decision making the husband's management of the business and the wife's lack of participation a controlling factor on the question of partnership, were each in conflict with the decisions of this Court, the Circuit Courts of Appeal, and Georgia, as stated in the Petition.

4. The particular questions, never decided by this Court, are vitally important to all who are concerned in a proper construction and administration of the Federal Income Tax Statutes.

1

Errors of Law. The preceding analysis of "Opinions of the Courts Below," with the "Questions" and "Reasons" stated in the Petition, we believe will suffice, without additional argument, to show clearly the reviewability of this case, if it appeals to the discretion of this Court as proper for review under Rule 38 (5, b).

2

Conflicts in Decisions as to Gifts. We earnestly appeal to the discretion of the Court for the grant of a writ of certiorari, because of the conflict between the decision of the Circuit Court of Appeals and the decisions of the Circuit Courts of Appeals for other Circuits, and Georgia decisions, as stated in the Petition, under the holdings of the courts below that essential donative intent in gifts is nullified by the donee's mere use of the proceeds, after the completion of all that was necessary to make a valid gift, and too long thereafter to have any significance, pertinence, or relevancy; and under the holdings of the courts below, failing to apply to the question as to valid gifts the rules of local law making a constructive or symbolic delivery sufficient, and failing to hold, as a matter of law, that the transfers of corporate stock on the books of the company, with other acts of the parties—all being without fraud or sham—made complete and valid gifts for Federal income tax purposes.

Such decision is also contrary to that in *Tower* v. *Commissioner* (6th Circuit Court of Appeals), 148 F. (2d) 388, 390 (in which a writ of certiorari has been granted), where a gift and partnership between spouses were sustained, although the facts were not as strong as here, the husband attaching a condition to the gift, and the question of mere "sham" was involved, instead of the present finding that there was no fraud of "shams designed to evade tax." (R. 78.) The appellate court decision and the holdings of the Tax Court also conflict with their own earlier decisions: in *Kell* v. *Commissioner* (5 C. C. A.), 88 F. (2d) 453, that, after completion of the gift and a partnership interest, the donor's use or handling of monies was "without significance to change the legal import and effect of his verbal and written direction;" in Tax Court cases cited with Circuit

Courts of Appeals decisions, but not applied, in the Memorandum Opinion (R. 52); and in *Southern Industrial Institute* v. *Marsh* (5 C. C. A.), 15 F. (2d) 347, nullifying a stock gift because of a condition imposed thereon, but holding that "the validity of the gift depends upon the laws of Georgia." The decision is also contrary to general law; citations being here out of place.

3

Conflicts in Decisions as to Partnership. Such conflicts with particular decisions have been fully indicated in paragraphs 3, 4, and 5 (b, c), under "Reasons for Granting the Writ," in the Petition. The decisions of the courts below, as to capital contribution by a wife, the husband's active management, and the wife's lack of active participation in the business, also conflict with many decisions by the Tax Court itself, sustaining such a partnership, unless the business is essentially one of the personal-service type where capital is not a factor of any moment in producing the income, and including: M. W. Smith, Jr., 3 T. C. 894; Robert P. Scherer, 3 T. C. 776; Davis B. Thornton, 5 T. C. 13; Felix Zukaitis, 3 T. C. 814; Estate of J. W. Holtiwanger, T. C. Memo. Op., Dkt. 4469 (Jan. 18, 1945); Julius Caesar Haley, T. C. Memo. Op., Dkt. 5568 (Jan. 23, 1945) (as to minors becoming partners by gift where permitted by State law); Glensder Textile Co., 46 B. T. A. 176 (recognizing limited partnerships where good under State law).

4

Important Federal Questions undecided by this Court. We believe that no elaboration of paragraph 6 of the Petition, under "Reasons for Granting the Writ", is necessary to demonstrate the vast importance of the questions, which remain undetermined by this Court, as to gifts and

partnerships in the light of the Federal income tax statutes, and as to whether and to what extent local law controls or is to be considered in such transactions, if there is no fraud, sham, or fiction, and the formalities (valid under local law, as under general law) are realities.

In conclusion, however—besides the importance of settling the conflicts with decisions of other Circuit Courts of Appeals and with local decisions—it seems to us that the views of tax writers on the unsettled situation with regard to these matters are pertinent. One scholarly authority has said: "One may assume from many dissents that the Tax Court has recently been having an internal struggle with the husband-wife partnership problem. Typical cases present the disparity of opinion within the court." Paul, Partnerships in Tax Avoidance, Vol. 13, No. 2, George Washington Law Review, p. 125. Another writer has expressed a like view: "A regrettable and unsettling condition has been created in which the majority court hands down several decisions rejecting partnerships between husbands and wives, and, two days later, *upon substantially the same facts,* sustains such partnerships. Each case carries with it dissenting opinions of as many as five members of the court. In two cases, one judge writes the majority opinions and the dissenting opinions in the cases immediately succeeding. This condition is not conducive to fostering the qualities of stability and confidence which courts must possess if their opinions are to be respected." Polisher, Family Partnerships, Taxes, Vol. 22, No. 7, p. 300.

Without adopting such views as our own, and with all deference to the United States Circuit Court of Appeals for the Fifth Circuit and to the Tax Court, we most earnestly believe that the legal rules and standards with respect both to gifts and to partnerships, under Federal income tax statutes and previous rules and under local laws, should

be settled and clarified by this Court, particularly as to the questions raised in this petition; that the correct principles should be established as they have been in cases involving trusts and corporations; and that rules thus laid down would be of incalculable value to all interested in the proper construction and administration of such laws. For these and other reasons stated in the Petition and this Brief, we sincerely believe that this is an eminently proper case for the grant of a writ of certiorari.

Respectfully submitted,

OLIVER C. HANCOCK,
CLIFFORD R. WHEELESS,
Counsel for Petitioner.